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RECENT EXPERIENCES IN EXPORT CREDIT FINANCING SCHEMES IN NORTH AFRICAN COUNTRIES

A note by the ECA secretariat

LC/NAIRCAL

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I. INTRODUCTION

1. Export credit financing is increasingly becoming a trade policy instrument in developing countries but in Africa, the experience is very recent. As a country shifts its production mode towards manufactured goods, the problems of marketing begin to emerge especially with respect to financing the various stages in export trade. The country enters into direct competition with the more powerful and better endowed developed countries in established markets. Competition in this field is no longer limited to prices, quality of goods, after sales service but also and more importantly terms of payments. It is in this context that export credit financing and insurance become of prime importance to any exporter seeking to enter a new market, or wishing to consolidate or expand an existing market. Many developing countries do not have such a system or if they do, it is at a very early stage of development. The purpose of export financing is mainly to assist exporters in the purchasing and processing of goods for exports. It also provides them with enough liquidity to enable them to offer competitive credit terms to overseas buyers thereby improving their export opportunities in foreign markets.

2. This note briefly examines the export credit financing situation in North Africa 1/. An attempt is made to analyse how the system operates, what are some of its merits that can be applied to other developing African countries and what specific problems have been encountered in the operation of this scheme. At the end of this paper, some proposals have been put forward to indicate prospects for improvement.

II. BACKGROUND ON OPERATIONS OF EXPORT CREDIT FINANCING SCHEMES

3. Broadly speaking, two types of export credit schemes are in general use: supplier's credits and buyers credits. The supplier's credit is a credit given by the supplier or exporter to the buyer or importer while the buyer's credit is a credit given by a credit institution in the supplier's country to the buyer. Since the exporters or suppliers are rarely capable of providing credit to their customers or importers out of their own funds, they always resort to financial institutions available in their countries for financing the credits they offer to their foreign customers.

4. The financial institutions on their part offer two basic export financing schemes for exporters. The first one is pre-shipment financing which consists of a credit given to the exporter with the objective of providing him with sufficient working capital between the time of receipt of orders from foreign customers and the time of shipment of goods abroad. This financing enables the local exporter or manufacturer to produce or manufacture the goods ordered but not paid for at the time of the order. The second financing scheme offered by financial institutions is post shipment financing which consists of a credit given to the exporter to bridge the gap between the time of shipment of goods and the time of receipt of payment from foreign buyers. These schemes are examined in some detail below. For the moment it is important to stress that this financing helps the local supplier to keep his export business running while waiting

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1/ North Africa comprises Morocco, Algeria, Tunisia, Libya, Egypt, Sudan.

for his sales proceeds to come in. A third method of export finance is that of factoring which consists of the sale by the supplier of his receivables to a factoring firm which then assumes responsibility for collecting the sales proceeds from foreign customers.

5. Both pre-shipment and post-shipment financing are offered by commercial banks but since commercial banks are sometimes reluctant to offer credit for long periods of time, special financial institutions have been established to cater for the long term credit needs of exports. These institutions include export import banks, export promotion funds and industrial development banks. In addition to the commercial banks and the specialized financial institutions there also exist refinancing institutions especially created to encourage and support the banks to participate effectively in export financing and protect the export sector from high interest rates and credit restrictions sometimes enforced by governments. The function of refinancing could either be performed by an institution especially created for this purpose or the central bank of the exporting country. One last and important element of export credit financing is the provision of insurance facilities to protect the exporter against commercial and non-commercial risks involved in the export business.

(a) Pre-shipment financing

6. Pre-shipment financing is designed to provide exporters with working capital to cover the cost of production of export goods and also the cost of storing, packaging and marketing these goods. This financing is granted on the basis of confirmed orders from abroad. In order to obtain the proceeds of his sales in advance, the exporter must provide the financing institution with a production plan containing a detailed account of the cost of raw materials and imported inputs required for the production of export goods including salary costs, costs of other inputs as well as a copy of his last balance sheet and profit and loss account. The exporter must also show the contract signed with the foreign buyer stipulating the type and nature of the transaction as well as the price agreed upon, the delivery conditions and the payment arrangements. This type of financing being risky because of the doubts that inevitably exist as to the authenticity of the export order and the competence and willingness of the exporter to meet his end of the bargain. The financial institution studies and evaluates very carefully the proposed transaction as well as the data available. If the transaction is approved the exporter receives an advance payment usually equal to 80 or 90 per cent of the free-on-board (f.o.b) value of his sales contract. The length of pre-shipment export credit usually depends on the nature of the transaction.

7. In general, credit is granted for a period of twelve months but may be extended to two or three years if the type of transaction requires a longer period of credit. The cost of this credit is always lower than the prevailing cost of credit on the market, but a collateral is always required. The collateral could consist of the transfer of ownership of the goods to the financial institution, promissory notes issued by the exporter or the mortgage of land, plant, machinery and other assets. Once the transaction has been completed and payment received, the financial institution is reimbursed the amount of money it has lent

plus interest. If an exporter's past performance has been satisfactory the financial institution could grant him a revolving pre-shipment credit to cover his successive transactions usually on the same terms as the first credit. The advantage of this arrangement is that it saves time and costs as the lending institution takes the original documents as the basis for the extended credit process and does not have to study and evaluate a great deal of information everytime the exporter undertakes an export operation. However, any development of significance in the operation of the exporter's business is always taken into consideration.

(b) Post-shipment financing

8. This is a credit given to the exporter to enable him bridge the gap between the time of shipment of goods and the time of payment from his overseas customer. The two most common instruments used in this type of financing are "bills of exchange" drawn by the exporter on the foreign buyer and letter of credit issued by a bank in favour of the exporter. The exporter submits the bill of exchange to a commercial bank together with documents certifying that the exports have been made (shipping documents). The bank studies the proposed transaction and approves it. It then discounts the bill and the exporter receives immediately the equivalent of the transaction value in local currency less interest and bank charges. The same process applies for letters of credit. Post-shipment financing could be short, medium or long-term.

9. Short-term credit is usually granted by commercial banks while the medium term credit is generally granted by specialized financial institutions such as export/import banks, insurance companies and export finance funds and is normally extended for a period not exceeding five years. These same specialized institutions also offer long-term financing which covers periods of 10 to 15 years. However, this credit is usually strongly backed by the government since the transactions usually involve major exports such as exports of capital goods, erection of plants and infrastructural works and require huge amounts of funds. For short term post-shipment credit, the exporter usually receives 80 to 90 per cent of the face value of his transaction. In the case of medium and long-term credit, the exporter is granted an amount equal to the face value of his bills less interest and bank charges. Such transactions, as in the case of pre-shipment financing cost less than the going cost on the money market.

10. An aspect of long-term financing which is particularly useful in international trade is that of buyer's credit which consists of a credit granted directly by a financial institution in the exporting country to an overseas buyer thereby enabling him to pay cash for his purchases. This has the effect of improving the liquidity position of the exporter who immediately obtains payment for his shipment. The lending institution requires detailed information on the buyer's standing before it provides this type of credit. Documents such as balance sheets, profit and loss accounts and an evaluation of the buyer by a bank in his country are usually required. Once the financial arrangements are concluded, the funds are credited to the buyer's bank account with the lending institution. The amount transferred is usually equal to 70 or 80 per cent of the total value of the contract, the remainder is usually immediately paid by the buyer. Upon shipment of the goods, the exporter receives payment from the lending institution in his country in accordance with the terms of the contract.

In this type of financing, the exporter has no obligation to the financing institution the buyer or importer being the only one responsible for repayment. This credit also requires a guarantee by the government or by a first class bank in the buyer's country. An important feature of buyer's credit is that the funds lent do not leave the exporter's country although the loan is granted to a foreign customer.

(c) Refinancing

11. In recent years, refinancing has become an essential component of export financing. This consists of a credit given to the lending institution by a specialized export institution or a central bank against the issuance of promissory notes or through the rediscounting of export bills. Once the financial institution approves the credit offered by a supplier, to his foreign customer, it applies for refinancing the export credit value at interest rates lower than those at which money is lent to the exporter enabling thereby the financial institution to make a profit. Before refinancing is approved the refinancing institution often requires an export credit insurance policy or a guarantee from a bank in the buyer's country. In most countries, export credit refinancing operations are usually carried out by the central bank of the exporting country, or by specialized export institutions specifically established for that purpose.

(d) Export credit insurance

12. Because of the high risks involved in export transactions, there is need for an export credit insurance scheme to protect local exporters from the uncertainties inherent in the business of selling to foreign customers. Export credit insurance is designed to protect the exporter against commercial as well as non-commercial risks. The commercial risks are those caused by the insolvency or default of the foreign buyer while the non-commercial risks are those caused by factors outside both the seller's and buyer's control. These may vary from trade restrictions imposed by governments to political disturbances and natural disasters. Insurance policies cover both pre-shipment and post-shipment periods. The pre-shipment insurance is especially suitable for the production of goods to buyer's specifications and which might not be easily resaleable. However, the insurance policy covers only risks arising from non-payment by overseas buyers; it does not cover those arising from the violation by the exporter of the terms of the contract of sales or his failure to comply with the import/export regulations of his own or that of the importer's country.

13. Export insurance companies normally require their customers to insure all their export transactions and not only their bad risks. Moreover, credit export insurance companies usually make sure that the exporter shares some responsibility in the risks involved in his export deal forcing him thereby to exercise prudent and sound business practices when extending credit to foreign customers. Upon receiving an order from abroad, the exporter normally fills in an insurance application form which usually contains such information as the description and value of the goods to be exported, terms of payment, credit periods required, length of export credit insurance, names and addresses of the overseas buyers etc. With all such information at hand, the export credit insurance company studies the proposed export transaction and decides whether or not to insure it.

If it decides to insure the export credit in question, the insurance company will then draw up a contract stipulating the risks covered, premiums to be charged, the liabilities of the parties concerned and the terms of settlement of claims, procedure of claims etc. If the export transaction is frustrated, the insurance cover comes into effect in accordance with the terms of the insurance policy.

14. Insurance policies of this nature usually cover 90 per cent of commercial risks and 95 per cent or 100 per cent of non-commercial ones depending on the prevailing circumstances. While insurance policies serve as collateral for export credit, export financing institutions do not regard them as a sufficient guarantee for credits granted. This is mainly because the policies do not usually cover such risks as non-acceptance of the goods by the buyer and non-respect by the supplier of the terms of the export contract. In order to cater for these extra risks, some schemes provide an unconditional guarantee to the export financing institution that does not depend on the validity of the exporter's claim under his insurance policy. 2/

(c) Factoring

15. Factoring is a technique of export financing widely used in developed countries which consists of the purchase by the factoring firm of the receivables of the exporter without recourse against him. A letter of agreement is signed by the exporter and the factor stipulating that the factor agrees to buy the accounts receivable of the exporter resulting from export transactions. Following this agreement the exporter sends to the factoring firm copies of bills of lading and other shipping documents pertaining to his sales abroad. Also, invoices sent to customers abroad should indicate clearly that payment should be made to the factoring company.

16. The factoring company in turn provides credit risk protection, accounts receivable book-keeping and collection of export proceeds. The factoring firm could either pay the exporter his accounts receivable upon shipment of the goods or later at a stipulated maturity date. This depends on the agreement between the factor and his client, the exporter. The factoring company charges commission for services provided in assessing and then assuming credit risks, undertaking accounts receivables book-keeping and collecting sales proceeds. It also charges interest on any amount of money advanced to the client.

2/ For example the export credit guarantee department of the United Kingdom (ECGD) undertakes to pay directly to the bank or the credit financing institution 100 per cent of any sum, three months overdue.

III. SOME EXPERIENCE IN EXPORT CREDIT FINANCING AND INSURANCE IN NORTH AFRICA

17. Export credit financing and insurance schemes are at an early stage of development in North Africa. From the information available in the ECA secretariat, Morocco and Tunisia seem to have built up the most advanced systems in the subregion. Morocco is among the developing countries which has adopted vigorous programmes for the expansion and development of their export sector. Other countries suchas Egypt have adopted an informal system of export financing. The general thrust for the North African countries is that in order to encourage its exports, a system of export credit financing and insurance has been set up whose main features are those described in Section II of this paper.

(a) Morocco

18. Morocco operates several aspects of export credit financing and insurance schemes designed to maximize her export potentials. These are briefly described below.

(i) Short-term export credits

19. These involve both pre-financing and post financing. In the case of pre-financing, each exporter has a fixed ceiling for the total pre-financing credit he is entitled to for a one-year period. This ceiling is determined on the basis of the exporters sales in the preceding year and in accordance with such other factors as the duration of the production cycle and the exporting firms financial position. In general, the ceiling is equal to one and a half months exports but more generous credit limits are granted to exporters whose sales are highly seasonal and which have received substantial firm orders from abroad and present sufficient and satisfactory evidence that their export sales are going to be much higher than the previous year.

20. Pre-financing credit is granted by commercial banks but can be rediscountable at 100 per cent of its value with the bank of Morocco, the Central Bank of the country. The interest payable by the exporter is between 5 and 7 per cent as against 9 to 10 per cent for non preferential but rediscountable short-term loans. The rediscount rate is 4 per cent thus leaving the commercial bank with a spread of 1 to 2 per cent without commitment of their own resources. The total pre-financing credits approved by the bank of Morocco has increased from Dirham 23.6 mn in 1979 to DH 83.1 mn in 1981 or an increase over 3 years of 350 per cent. 3/ This demonstrates clearly the popularity of this scheme with exporters.

3/ Bank of Morocco quoted in World Bank industrial, incentives and export promotion.

21. With regard to post-shipment financing, short-term export credit is granted by the banks for a period of 45 to 120 days at an interest rate of between 5 and 7 per cent. This credit is rediscounted with the central bank at a rate of 4 per cent just like pre-financing credit, leaving the banks with a spread of 1 to 3 per cent.

(ii) Medium- and long-term export credit

22. Medium- and long-term export credits were introduced in Morocco in 1982. These credits are discounted at 100 per cent of their value if their value exceeds the minimum percentage for medium and long-term credit set for each commercial bank. Only capital goods incorporating at least 30 per cent of domestic value added qualify for such credits. The maximum maturity period for such credits is five years. The credits are denominated in Dirhams or any other currency quoted by the Bank of Morocco. The exporter benefiting from such loans pays an 8 per cent interest rate. The central bank rediscounts these credits at a 5 per cent interest rate. However, the refinancing of these credits requires the intervention of the Moroccan Bank for external trade (Banque marocaine pour le commerce exterieur (BMCE) to evaluate and assess the transaction in question.

(iii) Export credit insurance

23. The credit insurance scheme in force in Morocco covers commercial as well as non-commercial risks. There is also a system of trade fair insurance and coverage for promotion and advertising. Ordinary commercial risks involved in export credit are covered by the Moroccan Bank for external trade out of its own resources or sometimes with the financial support of the State. Political risks, natural disasters and special commercial risks related to trade fair insurance and cover for advertising and promotion are covered by the State. However, so far no budgetary provisions have been made by the State to cover risks for which the State is responsible the Moroccan Bank for external trade has had to assume all risks involved in export trade and as a result has grown highly selective in deciding on the operations to insure.

24. For commercial risks the percentage guaranteed is 70 per cent, 80 per cent or 90 per cent depending on the country of destination. For political risks the percentage is 80 per cent or 90 per cent. Premiums are scaled to the risk classification of the country of distination of exports. Up to now payments in the event of a loss do not exceed 30 times the amount of the premium paid by the insured. According to the Moroccan bank for external trade export credit insurance covered about Dirham 350 mn in mid-1982 which was roughly 10-15 per cent of the amount insurable. Trade fair insurance and insurance coverage for promotion and advertising amounted to Dirham 1 mn for the same year.

(iv) Protection against exchange risks

25. It is possible in Morocco to buy or sell forward foreign currencies with commercial banks provided the sale or purchase of these currencies is in connection with an export sale or temporary imports. In so doing, an importer or exporter can cover himself against the risk of exchange fluctuations. The commercial banks cover their foreign exchange risks with the bank of Morocco. The forward exchange rate is set equal to the last spot rate fixed by the bank of Morocco and a commission of 2 per cent per annum is payable on all forward sales and pruchases of foreign currencies. The maturity period fixed for these operations is of 180 days.

(b) Tunisia

26. As part of its export drive, the Tunisian Government offers a large number of incentives to exporters which include the reduction by 20 per cent of corporate tax on the part of the production to be exported, the exemption from sales taxes on goods and services bought on the local market and used in the production of exports, the simplification of formalities of imports to be used in the production of exports. In addition to these incentives, there exists a system of export credit financing and insurance consisting of the elements described in the next few paragraphs.

(i) Short-term credit

27. Short-term credit is granted for both pre-shipment and post-shipment goods and is subject to an interest rate of 6.5 per cent and benefit from an unlimited rediscount facility with the Central Bank at an interest rate of 4.75 per cent leaving the commercial banks with a spread of 1.75 per cent. Pre-financing credit is usually provided for imported goods and services acquired by exporters. The financing of export transactions is strictly controlled by the Central Bank of Tunisia and exporters are required to transfer the proceeds of their exports into the country and are allowed 4 per cent of the value of their sales in convertible dinars to cover incidental expenses related to their export business. Commercial Banks could only discount claims on foreign transactions of less than 90 days.

(ii) Medium- and long-term credit

28. This type of credit is granted by the Central Bank through the commercial banks on a case by case basis and is tailored to suit the needs of the very few manufacturers who export capital equipment (transformers, railway wagons, metal structures etc.).

(iii) Export credit insurance

29. An export credit insurance company, the Compagnie tunisienne d'assurance des credits a l'exportation (COTUNACE), was established in 1984 with the objective of covering the majority of losses which an entrepreneur can incur on his export operations because of non-payment by the foreign buyer for commercial or non-commercial reasons. The insurance policies issued by the export credit insurance company will serve as a collateral and encourage the banks to finance the export business.

(c) Egypt

30. In Egypt, there is no export credit financing of the type described in Section II of this paper. However, credit is sometimes provided for export purposes. An import/export bank has been established to finance foreign trade. Short-term credit is provided by the four public sector commercial banks available in Egypt. Medium and long-term financing of investment projects, including export oriented projects, is provided primarily by the development industrial bank of Egypt. The interest rate on export loans is fixed by the Central Bank of Egypt at a maximum of 13 per cent per annum which is not a preferential rate as this is the same rate applied for agricultural and industrial loans. The discount rate of Central Bank of Egypt is also fixed at 13 per cent.

31. Commercial banks require confirmed letters of credit for most export transactions and export against documents on payment, documents on acceptance and consignment are not favoured by the banks. Moreover exchange control regulations require export proceeds to be transferred into the country within 90 days or in exceptional cases 180 days. There is no credit guarantee and insurance scheme in Egypt but the government envisages to turn the present import/export bank into an export development bank with responsibility for financing foreign trade, providing refinancing facilities and export credit guarantee and insurance.

IV. PROBLEMS AND PROSPECTS FOR EXPORT CREDIT FINANCING IN NORTH AFRICA

(a) Morocco

32. Although in Morocco a relatively sophisticated export financing system exists, there are certain problems that require specific mention. The first problem area is the credit limits in force for pre-financing of exports, which limit the resources available to exporters. These credit limits can sometimes be waived but there is a clear need to allow exporters or potential exporters to have access to enough funds to enable them to produce goods for exports, based on the appraised needs of the exporter.

33. The second problem relates to short-term post-shipment export credit. Presently, the maturities are too short 45 to 120 days while normally the type of credit is extended for a period which could reach 12 months. A reasonably sufficient period of time should be allowed for receipt of export proceeds so as not to put more burden on exporters who sometimes have to raise money to pay their loans on maturity before they receive payment from abroad. Similarly, short term export credit in Morocco is deducted by the banks from the exporter's credit allowance depriving the exporter from access to other credits from the banks. This export credit quota system is not conducive to export development and should be relaxed.

34. The third problem is that at the moment, medium and long term export credits are limited to capital goods. However, in order to diversify the export base, it would be necessary to extend to other export areas such as

public works, and building and engineering services where Morocco might have a comparative advantage. Similarly, the maturities set for this type of credit do not meet international standards when it comes to competing in building or engineering exports which require a credit period of more than the five years now in force in Morocco.

35. With regard to the export credit insurance system, there are also limitations. Presently this is operated by the Moroccan Bank for Foreign Trade which normally covers only ordinary commercial risks. However, in view of other risks involved, it is suggested that the State should consider participating more actively in export credit insurance especially the coverage of non-commercial risks. This will greatly boost the confidence of exporters and expand Moroccan exports. It may also be advisable to establish an autonomous export credit insurance company to deal with commercial as well as non-commercial risks. The existence of an efficient export credit insurance scheme determines to a large extent the success of a country's export drive.

(b) Tunisia

36. In Tunisia, banks can only discount claim abroad of less than 90 days which is too short maturity to allow for some transactions to be completed. The Tunisian Insurance Company, which was established in 1984, is definitely a good step forward in export financing but it is too soon to comment on its effectiveness and its contribution to Tunisian export expansion. Medium term finance in Tunisia is provided by commercial banks in conjunction with long term finance provided by development banks. This arrangement is mainly due to the relatively small size of commercial banks and their limited project appraisal capacity. It is proposed that the Government should consider establishing a specialized export credit financing institution with necessary central bank backing to take care of medium as well as long-term financing of exports.

(c) Egypt

37. In Egypt, the bulk of manufactured exports is generated by the public sector which accounts for most of the exports particularly of textiles mainly cotton yarn and aluminium. These exports are generally channelled through State trading companies for which finance poses no problems as trade is conducted through well established commercial channels and standard payments practices are followed. On the other hand, exporters of non-traditional items in Egypt find it extremely difficult to obtain finance allowing them to offer competitive credit terms abroad. At the same time, funds in Egypt are very hard to raise in the sense that collateral in the form of land, machinery, etc, is always required by the banks. In such a situation, the small and new exporters find it hard to enter the export market as they cannot afford to comply with the requirements of the banks to obtain finance. A more flexible approach to export financing together with the lowering of the requirements laid down for export finance would significantly improve the exports.

38. Another problem relates to sales documents-on-payment or documents-on-acceptance or consignment which are not readily accepted by the banks for the provision of export credit finance. Moreover, the exchange control regulations of Egypt which require exporters to repatriate their export proceeds within 90 days of the date of shipment or in exceptional cases within 180 days of the same date. This is obviously a very rigid regulation that limits the maturity of the credit that the exporter could offer to his foreign client. The Government might wish to consider that the mandatory number of days within which the exporter has to repatriate his proceeds should be relaxed at least for certain types of goods (i.e. capital goods) which involve large sums of money which the foreign buyer could not always raise within a short time.

V. CONCLUSIONS

39. In North Africa the export credit financing and insurance schemes as a means of promoting exports are relatively new. The countries vary in their style of economic management, resources, markets and other conditions. Recent trends show a shift towards better export management systems of which export credit financing is gaining in importance. There is also the recognition by the governments that if they are to develop the export sector of their economies, they will have to adopt a rational approach to export promotion within the context of a well defined development strategy. The export credit and financing scheme is but one of the instruments necessary for export promotion, but if it has to have the desired impact, it must be accompanied by other policy instruments such as better access to foreign exchange for importing inputs necessary for export production; exemption from tariffs of imported inputs to be used for export production; fiscal incentives at the exporting firm level as well as other marketing tools such as advertising and sales promotion.

40. The absence of financial and money markets in North African countries places heavy responsibility on governments for the provision of export financing. The government policy in encouraging financial institutions to provide the financing needed for exports is therefore, of prime importance. In this connection, pre-shipment financing should be treated as a first priority in the early stages of export development drive since it is essential for the production of goods at competitive costs. A facility for pre-investment financing is also essential at this stage whose aim would be the provision of funds for the preparation of programmes on the expansion and diversification of North African exports. It would also engage in the financing of export promotion activities such as trade fairs, advertising, permanent exhibitions. In short, as an essential element of export promotion, the North African countries should intensify their efforts in strengthening the export credit financing and export credit insurance. Special emphasis should be placed on export promotion to other African countries within the context of intra-African Trade.